Dealing with Agricultural Subsidies under the WTO Agreement on Agriculture ,,, and Beyond

INTRODUCTION

A major outcome of the Uruguay Round of multilateral trade negotiations under the GATT was the WTO Agreement on Agriculture, (referred to in this technical briefing as "the Agreement") which came into effect January 1, 1995. The Agreement focuses on three areas: market access, domestic support, and export subsidies. These are the same areas of focus as those of the farm talks today in the current Doha Round of multilateral trade negotiations. A key objective of the Agreement was to exercise multilateral discipline over agricultural support policy and to reduce trade-distorting domestic support for agricultural producers in all member countries, while at the same time giving governments significant autonomy to design domestic agricultural policies responding to a wide variety of specific circumstances in individual countries and individual agriculture sectors. The Doha Round of multilateral trade negations seeks to find win-win solutions for reducing subsidies further on both agricultural and nonagricultural products and services. In the meantime, as the Doha Round proceeds, a recently initiated challenge to US cotton subsidies under the current rules (those of the Agreement now in force) is being resolved by the dispute settlement process.

BRIEF DESCRIPTION OF THE WTO AGREEMENT ON AGRICULTURE

The WTO Agreement on Agriculture reached in the Uruguay Round (referred to in this technical briefing as "the Agreement") established commitments by signatory countries to limit and reduce their "baseline" domestic supports to agricultural production and exports as measured by the Aggregate Measure of Support (AMS) on both product-specific and non-product specific bases. One of the key components of agricultural reform rules under the Agreement was reduction in due time, taking account of the economic and political costs of adjustment to new rules of the game, of domestic support of most kinds to domestic agricultural products and producers, so that countries' agricultural sectors can compete with one another in world markets on the basis of natural comparative advantage rather than artificially supported and uneconomic domestic subsidy-based advantages. The key distinction is between domestic support policies that distort international trade in agricultural goods and those that do not. The Agreement features special and differential treatment to developing and less developed countries, giving the former group a longer time period than developed countries for phasing out trade-distorting domestic support measures to their agricultural producers, and exempting the latter altogether from the obligation to phase out such measures.

MARKET ACCESS

The component of the Agreement dealing with Market Access (Part III, articles 4 and 5, and Annex

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5 of the Agreement) requires that non-tariff barriers (NTB) to market access be replaced by equivalent (in their effects on prices) tariffs. Signatory countries agreed to convert all their NTBs (e.g. quantitative import restrictions, variable import levies, discretionary import licensing) to ordinary customs tariffs equivalent in their protective effect to the measures they replaced and to bind these and any other existing tariffs. Countries further agreed that all tariffs were to be reduced from their base period rates (1986 rates for existing tariffs and 1986-88 rates for tariff equivalents replacing NTBs) on a simple average basis by 36 percent in six years in the case of developed countries and 24 percent in ten years in the case of developing countries, with minimum reductions of 15 percent and 10 percent respectively. No reduction at all was required in the case of less developed countries. The U.S.-proposed method for calculating a tariff equivalent to an NTB involved calculating the gap between domestic price and international price that could be attributed to the existence of the NTB and setting the rate of tariff so as to produce the same gap. The guidelines adopted for replacing import quotas with import tariffs allowed governments considerable room for discretion and maneuver in their interpretation of the process. Countries often produced a significantly higher initial tariff level than would have been actually equivalent in its effect to the NTB replaced, while minimizing the amount by which these tariffs were to be reduced over the stipulated period

DOMESTIC SUPPORT MEASURES (SUBSIDIES IN FAVOR OF PRODUCERS)

A good deal of the Agreement (articles 1, 6 and 7) is devoted to defining and setting limits on subsidies or domestic supports of various kinds to provided to agriculture, that is, "levels of support … provided for an agricultural product in favour of the producers of the basic agricultural product and of non-product support provided in favour of agricultural producers in general." (Article 1, Definition of Terms).

In WTO terminology, subsidies are considered as being sorted out into boxes of different colors. There are four boxes, which can be thought of as corresponding to traffic light signals of different colors, red, amber (orange), green and blue, into which subsidies are placed to indicate their varying degrees of badness. (No reference to different colored boxes is made, however, in the Agreement itself). Subsidies placed by an agreement in the red ("stop and desist") box are forbidden. However, in the Agreement, there is no "red box" category of subsidies. The 'amber box' category under Article 6 of the Agreement, refers to all non-exempted domestic support measures that are considered to distort production and trade[1] (with certain exceptions). Support measures of these kinds are limited to strictly *de minimis* levels - developed countries being limited to providing at most minimal support, consisting of a 5% or less rate of subsidy to agricultural production in developed countries, and in developing countries a rate of at most 10 % or less.

In the 'green box' ("go ahead, no problem") category under the Agreement's Annex 2 are subsidies that are exempted from restraint/reduction under the Agreement, such as investment subsidies and input subsidies "of the kind normally" provided in developing countries. In order to qualify for green box status, the subsidies must not distort trade or, at most, must cause only minimal distortion. They have to be funded out of general government revenues (and not by charging consumers higher prices as tariff-generated revenue does) and must not involve price supports. Government funding of agricultural research or training, for example, is considered to fall into the "green box" category**.**

The 'blue box' ("none of the above" or "we'll figure out where to put this stuff later") under Paragraph 5 of the agreement's article 6, refers to types of subsidies exempted from reduction commitments, even though in the view of some countries some of them may be having an important distorting effect on production and international trade in agricultural commodities. Opinions about this among participating members may differ as to how distorting, if at all, they are.

Domestic supports decoupled from the production decisions of the producers go in the blue box category. Supports for producers of a commodity are considered to be "decoupled" if producers of the commodity are given support on the basis of their output of the commodity in a fixed, past time period, not on the basis of how much of the commodity they are producing or how much they are losing in producing it. The result is that producers receiving this kind of support can be seen as responding to rational expectations of prices and costs, the same as would producers who do not receive any kind of support whatsoever. A possible objection to such a subsidy is that it may keep producers of the product in business of producing it as price expectations improve whereas otherwise they might have withdrawn from being even marginal producers of it. No limits on spending on blue box-exempted subsidies are imposed. One statement on the WTO web site, however, has it that blue box status subsidies are those involving reduction of production of the respective commodities by producers receiving the subsidies.

EXPORT SUBSIDIES

A third component of the Agreement (articles 8 and 9) deals with export subsidies, considered to be the most trade-distorting of all subsidies. This part of the Agreement specifies limits on export subsidies and sets time schedules for their reduction. Recognizing that a number of countries relied on various kinds of subsidies to dispose of their surplus production in international markets, the Agreement permits the continued use of six categories of subsidies for this purpose, contingent on signatory countries having made a commitment to reduce both budgetary outlays and the volumes subsidized on product-by-product basis. Countries which have not given subsidy rate reductions commitments are prohibited from using export subsidies on agricultural products (a kind of "red-box like" feature of the Agreement).

The agreement states that developed countries must reduce budgetary expenditures on export subsidies to a level of 36 percent below that of 1988-1990 base period, and the volume of subsidized exports by at least 21 percent on a product-specific basis with reference to the same base period. For developing countries, the required reductions are two-thirds of those of developed countries and over a ten year period (i.e. the required reductions relative to the base year numbers are 24 percent and 14 percent respectively). No reductions at all are required for less developed countries. (See the earlier EG Technical Brief on less developed countries (once known as "least developed" countries). In circumstances in which the value or volume of subsidized exports have increased since the 1986-90 base period--as may for example be the case for countries not part of the WTO Agricultural Agreement until just recently, 1991-1992 may be used as a beginning point for scheduled reductions.

MEASURING AGRICULTURAL SUBSIDIES TOTALLY: THE AGGREGATE MEASURE OF SUPPORT (AMS)

The Aggregate Measure of Support (AMS) measures a country's domestic support to its agriculture through subsidies as the monetary value of the amount of support being provided by the government to a sector. For some kinds of support measures "budgetary subsidy equivalents"- i.e. the amounts of subsidy payments that would be needed to substitute for – or would have the same effect as - the support measures in question - have to be calculated and added up to get a total Aggregate Measure of Support. The Total AMS is defined as the sum of all domestic support, including the budgetary equivalent of certain measures that have no explicit budgetary cost, provided in favor of a country's agricultural producers. Total AMS is the monetary value of all aggregate measures of support for basic agricultural products, all non-product-specific aggregate measures of support, and all equivalent measures of support for agricultural support. In reality, there are many ingenious/complex forms of subsidy, and thus the rules for deciding whether a product is being subsidized or not or how much "budget subsidy equivalent" support the product's production is getting, are not always straight forward. Alternatively, an "Equivalent Measure of Support" (EMS) is used when calculations of product-specific AMS are not feasible. The EMS is calculated on the basis of budgetary outlays or the money spent by government to support a product.

To be successful in a dispute with another member country over supports/subsidies that country may be giving to some of its agricultural products, a member county needs to be able not only to show that such subsidization is being provided by the country in amounts above *de minimis* levels but that imports of subsidized products from the country in question are 'hurting' or 'causing injury' to domestic agro-industry.

WTO RULES FOR CALCULATING AMS: A HYPOTHETICAL EXAMPLE FOR AN IMAGINARY COUNTRY

In the Total AMS calculation as prescribed by current WTO rules, the subsidy of a price support for a commodity is generally measured by multiplying the difference between the domestic support price of the commodity and a specified **fixed** external reference price ('world market price'), by the quantity of production eligible to receive the support price (or "administered price" as it may be called). For each commodity, the estimated subsidy of price support measures is added to other explicit subsidies – such as a product-specific fertilizer subsidy for example – that help the producers. Doing this, one arrives at a commodity -specific AMS which is then evaluated against the *de minimis* threshold for that product. Non-product specific subsidies are calculated separately, and, are included in the Current Year Total AMS only if they exceed the relevant *de minimis* level. For the non-exempt categories, price support measures have been the most important type of policy measure. The external reference price for each commodity is an average of annual export fob unit values taken over a specified number of prior years for countries exporting the commodity and cif import unit values for those importing it.

In any year of the implementation period, the Current Total AMS value of non-exempt measures must not exceed the scheduled AMS limit as specified in the schedule for that year. A country with no scheduled reduction commitments, unless a domestic support is covered by exceptions, must keep its subsidies levels of both the product-specific type and the non product-specific type at no more than *de minimis* levels.

In the following example, the hypothetical country has "amber box" ("orange light") status support measures specific to three agricultural products, wheat, barley, and oil seeds, as well as "amber box"-relegated non product-specific measures. The AMS measures of these supports are in two cases (barley and non-product specific) are below "de minimis" levels – i.e. are OK – too small to matter. But on two products (wheat and oil seeds) they exceed the respective "*de minimis*" levels and may be subject to challenge upon expiration of the "due restraint" clause governing members' challenges of each others' policies.

Example of the Aggregate Measure of Support (AMS) for an Entire Agricultural Sector by “Amber Box“ Measures *Calculation of the current Total AMS for a hypothetical country in a given year*	
Wheat Domestic producer support price for wheat = $255 per ton Fixed external reference price (world market price) =$110 per ton Domestic production of wheat =2,000,000 tons Value of wheat production =$510,000,000 (= $255 x 2,000,000) Wheat’s aggregate measure of support (AMS) (AMS1) ($255-$110)* 2,000,000 tons =$290,000,000 (versus *de minimis* level of support =$25,500,000) ***Barley*** Deficiency payments for barley from the government budget =$3,000,000 Value of barley production =$100,000,000 Barley AMS (AMS2) =$3,000,000 (versus a *de minimis* level of $5,000,000, so barley’s AMS is not counted in total AMS for the entire agricultural sector)	***Oil Seeds*** 1) Deficiency payments for oilseeds =$13,000,000 2) Fertilizer Subsidy for fertilizer used in oil seeds production =$1,000,000 3) Value of domestic oil seeds production =$250,000,000 4) Oil seeds AMS (AMS 3 = (1) + (2) =$14,000,000 (versus *de minimis* level=$12,500,000) ***Support Not specific to products*** Generally available interest rate subsidy =$4,000,000 Value of total agricultural production =$860,000,000 Non-product-specific AMS (AMS 4) =$4,000,000 (versus *de minimis* level of $43,000,000, therefore not counted in total AMS for the entire agricultural sector) **Current Year Total AMS (AMS 1 + AMS 3) = $304,000,000** **Note the AMS2 (barley) and AMS4 (support not specific to products) are not counted in the total because they are below de minimis levels.**

As noted there is no red box for subsidies in the Agreement, and any products to which the country applies supports of blue box status are not included in calculations of its total AMS or EMS.

TEMPORARILY EXEMPTED MEASURES ON WHICH DISPUTS AND DISPUTE RESOLUTION WERE POSTPONED BY OPERATION OF THE “DUE RESTRAINT” CLAUSE OF THE AGREEMENT

Article 13 of the Agreement, entitled ‘Due Restraint,’ but more popularly known as the Peace Clause, prohibited countries from challenging other countries’ use of export subsidies and domestic support programs that are otherwise permitted in the agreement. Under the Peace Clause, another country’ agricultural subsidies could not be challenged by another country if that country considered they undermined its export performance. Export subsidies are also similarly protected under the Peace Clause. Subsidies covered under Article 6.5 (the Blue Box) or the Aggregate Measure of Support (Amber Box) can face countervailing duties but members must exercise ‘due restraint’ in imposing the duties. Annex 2 (the Green Box) is fully protected by the Peace Clause, with no requirement to stay below the 1992 spending level. For countries to be protected by the Peace Clause, spending on support measures under the blue and amber boxes should not exceed the 1992 level. For the most part, the language of the Peace Clause is vague and is part of the bargain that developed countries struck to break the deadlock on agriculture during the Uruguay Round. The peace clause was to last for only 9 years from when the Agreement came into effect (in 1995) and is assumed to have expired on December 31, 2003. This was confirmed by the decision to rule on the recent complaint brought by Brazil against U.S. subsidies to U.S cotton farmers. Article 20 obliges countries to keep on negotiating.

What effects may the Peace Clause’s expiration be expected to have for developed and developing countries and the pattern of trade in agricultural products? Its expiration opens producer supports in the “blue box” to the dispute resolution process, but in doing so will not necessarily lead to their abolition. In the recently initiated cotton dispute between Brazil and the United States, Brazil contended that the subsidies granted by the government of the US to its cotton farmers, such as marketing loans, export credits, commodity certificates and direct payments, are depressing the world price of cotton and are causing harm to Brazilian cotton growers. The U.S. position is that the subsidies in question are "decoupled" from production – they are not given in proportion to a farmer's production of cotton, nor linked to planting of cotton. Therefore they do not contribute to overproduction or affect world price of cotton adversely, nor do they harm cotton producers of other countries. There have been two rulings by WTO panels on this dispute.

The first WTO panel ruled that export credits provided by the US qualify as export subsidies, which must be reduced immediately in order to conform to the Agreement. The effect of such a reduction if it were carried out would (but not if the decoupling argument is correct) presumably be to increase not only Brazil's share of the world cotton trade, but also that of a number of other countries for which cotton is an important actual or potential export crop, while reducing that of US producers. Another, more recent ruling, by another WTO Panel is viewed by U.S. negotiators as effectively recognizing the validity of the official U.S. position that the U.S. cotton growers' subsidies are decoupled from production and therefore acceptable under the terms of the Agreement. In the meantime Doha Round negotiations are at grips with agricultural subsidies issues which at one point this summer threatened to bring them to an impasse. But a breakthrough on how to negotiate about agricultural subsidies has been made (a negotiating framework has been agreed), and so both Doha Round negotiations and ongoing legal proceedings continue to deal with agricultural subsidies issues.

**This technical briefing heavily relies on information available on the official WTO web site, www.wto.org and on the USTR web site and www.ustr.gov. both of which readers may be interested in visiting for basic texts of agreements, descriptions and interpretations of current rules, information on-going disputes in process of being resolved, and negotiations on agricultural trade and support issues

ENDNOTES:

[1] Some free-trade minded and "least cost-solution" oriented international economists have argued that production subsidies are welfare-superior to protective tariffs because they distort only the country's domestic production of and trade in the commodity without distorting consumption. The country's imports of the commodity are reduced only by the amount the subsidy increases its domestic production, and not by an additional amount due to discouragement of domestic consumption. But looking at the matter in a more comprehensive and systematic way, we see that producer price-supporting or subsidizing measures can distort trade further than this because governments providing such price supports on too large a scale to their farmers end up accumulating stockpiles of the agricultural commodities and sell some of the surplus abroad. Large enough domestic subsidies to production of commodities end up having an export subsidy effect, consumption of the product is increased both at home and abroad – at lowered prices – so that only producers abroad, and taxpayers at home, who foot the bill for the stockpiling and the exportation of the surpluses, are harmed, not consumers at home or abroad. However, the interesting point may be made that the Agreement is concerned only about production and trade, and not explicitly about whether consumption is distorted.